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In the Supreme Court of the United States

OCTOBER TERM, 1931

NO. 341

DAVID BURNET, Commissioner of Internal Revenue,
Petitioner,
vs.
CORONADO OIL & GAS COMPANY,
Respondent.

On Writ of Certiorari to the Court of Appeals of the District of Columbia

BRIEF AND PRINTED ARGUMENT FOR RESPONDENT

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BRIEF AND PRINTED ARGUMENT FOR RESPONDENT

STATEMENT OF CASE

LEGISLATIVE HISTORY OF OKLAHOMA SCHOOL LANDS

Congressional Legislation

Section 3, subdivision 5, of the Oklahoma Enabling Act (34 Stat. L. 267, 269) required, as a condition of the State's admission into the Union, that in its constitution "provision shall be made for the establishment and maintenance of a system of public schools which shall be open to all the children of said State and free from sectarian control."

Section 7 of the Act granted to the State for the bene-

fit of the common schools the sections of land numbered 16 and 36, with certain exceptions, in every township in Oklahoma Territory, included in which was the land subsequently leased by the State to respondent.

Section 8 (Appendix A) provided that such of the granted lands as were valuable for oil or gas should not be sold prior to January 1, 1915, but might be leased by public competition, after not less than thirty days advertisement, to the highest responsible bidder for periods not exceeding five years; that the leasing should require and the advertisement specify a fixed royalty in addition to any bonus offered; that all proceeds from leases should be paid into the fund to which it belonged; that no transfer or assignment of any lease should be valid or confer any right in the assignee without the consent of the proper State authorities in writing; and that the State legislature might enact additional legislation not in conflict therewith governing such leases.

Section 9 (Appendix A) provided that the proceeds of the granted lands, if any when sold, should constitute a permanent school fund, the income from which should be used in the support of such schools.

Section 22 required "that the Constitutional Convention provided for herein shall, by ordinance irrevocable, accept the terms and conditions of this act."

Oklahoma Constitutional and Statutory Provisions

By article XI, section 1, Oklahoma constitution (Appendix B), the State accepted the grant for the uses and purposes, upon the conditions, and under the limitations specified in the Enabling Act, and pledged its faith to preserve and keep the lands and the proceeds thereof for the purposes for which they were granted. And, pursuant to section 22 of the Enabling Act, the Constitutional Convention of the State enacted an irrevocable ordinance accepting the terms and conditions of the Act (Appendix C).

Conforming to the 5th subdivision of section 3 of the Enabling Act, section 5 of article I of the State constitution provided that:

> "Provision shall be made for the establishment and maintenance of a system of public schools which shall be open to all the children of the State and free from sectarian control; and said schools shall always be conducted in English."

Further conforming to that requirement, article VI, section 1, of the State constitution created the office of Superintendent of Public Instruction, and made that officer a member of the executive department of the State. Article XVII, section 2, created the office of Superintendent of Public Instruction in each county of the State. Article XIII, sections 1 and 4, required that the legislature establish and maintain a system of free public schools wherein all the children of the State might be educated, and provide for

the compulsory attendance at some public or other school of all children in the State of sound mind and body between the ages of 8 and 16 years for at least three months in each year; and section 5 of that article vested the supervision of instruction in the public schools in a board of education composed of the Superintendent of Public Instruction, the Governor, the Secretary of State, and the Attorney General (Appendix C).

Article XI, sections 2 and 3, of the constitution (Appendix D) created a permanent school fund for the benefit of the common schools, consisting in part of the proceeds of the sale and the income from the leasing of the granted lands, and provided that the income therefrom should be apportioned among all the common school districts in the State in proportion to their scholastic populations.

Article VI, section 32, of the constitution created a branch of the executive department known as the Commissioners of the Land Office, composed of the Governor, the Secretary of State, the State Auditor, the Superintendent of Public Instruction, and the President of the Board of Agriculture, to which was given charge of the sale, rental, disposal and management of the school lands and other public lands of the State, and of the funds derived therefrom, under rules and regulations prescribed by the legislature (Appendix E).

The legislature of 1910 authorized the Commissioners

of the Land Office to make such rules and regulations governing the leasing of the public lands as they should deem proper, not in conflict with the Act (section 9401, Compiled Oklahoma Statutes 1921).

The first legislature enacted sections 9415, 9417, 9418 and 9423, Compiled Oklahoma Statutes, 1921 (Appedix F), providing that the Commissioners of the Land Office should ascertain and enter of record what portion of the granted lands were valuable for oil and gas, and that the same should be withheld from sale; that the oil and gas thereunder might be leased in the manner and for the period provided in the Enabling Act, the lessee to be required to drill a sufficient number of wells to offset the wells upon contiguous premises, to faithfully operate the leased lands for oil and gas, and to give a bond for the faithful performance of the terms of his lease; that no transfer or assignment of any lease should be valid or convey any right in the assignee without the consent in writing of the Commissioners of the Land Office; that the commissioners might make additional rules and regulations; and that the bonuses and royalties under such leases should be carried to the several funds for the benefit of which such lands were granted.

The legislature of 1917 enacted sections 9424 to 9430, inclusive, Compiled Oklahoma Statutes, 1921, containing substantially the same provisions as those just referred to (Appendix G).

It was under the foregoing constitutional and statutory provisions that the leases to respondent were executed, from the operation of which were derived the income and profits sought to be taxed.

Acts Done Pursuant to the Foregoing Constitutional and Statutory Provisions

December 4, 1913, the Commissioners advertised that, on January 9, 1914, they would receive sealed bids for the leasing for oil and gas purposes of a certain 480 acres of the granted land, for a term of five years, with preference right to re-lease for an additional like period, under the laws of Oklahoma and the rules and regulations of the Commissioners, at a royalty of fifty per cent of all oil and gas produced therefrom, and in addition such bonus as might be offered therefor; and that the terms of the lease to be executed should conform to and be governed and construed by and under the laws of the State and the rules and regulations of the Commissioners (R. 61-2).

Under statutory authority the Commissioners had adopted and printed rules and regulations for leasing the public lands for oil and gas purposes (R. 62-3). These required that the successful bidder give a bond approved by the Commissioners for the faithful performance of his contract and to develop the lands sufficiently to extract all the oil and gas thereunder with the least possible delay;

that all producing wells drilled on adjoining properties should be offset by corresponding wells on the leased tract; that a certified copy of pipe line runs and of all sales and shipments be furnished monthly on demand; that accurate information concerning the wells and their operation and management be furnished on demand to the Commissioners or to anyone authorized to act for them; and that the lease should conform to and be interpreted and construed by the laws of the State of Oklahoma and the rules of the Commission.

The lease (R. 67-72), modeled upon those prepared by the Interior Department for leasing lands in Osage Indian Reservation dealt with in *Indian Territory Illuminating Oil Company* v. *Oklahoma,* 240 U. S. 522, recites that in pursuance of the Constitution and the laws of the State of Oklahoma, the lessors, in consideration of the royalty, covenants, stipulations and conditions therein expressed, to be paid, observed and performed by the lessee, do thereby lease and let unto the lessee, its successors and assigns, for a term of five years, all oil deposits and natural gas in and under the land described. The lessee therein agreed to pay a royalty of fifty per cent of all oil and gas produced; to operate the wells at their full capacity; not to abandon or plug any well without the written consent of the Commissioners; to furnish the Commissioners certified copies of guage tickets, sales and shipments; to exercise diligence in drilling for oil and gas; to drill a sufficient number of

wells to offset each well drilled on adjoining premises; and to develop the lands as required by the laws of the State and the rules and regulations of the Commissioners. It was provided that the lease should in all respects be subject to the rules and regulations theretofore and thereafter lawfully prescribed by the Commissioners, and that neither the lease nor any interest therein should be sublet, assigned, or transferred without the consent of the Commissioners first obtained in writing. The lessee was given the preference right, upon the expiration of that lease, to re-lease the premises for a second term of five years at the maximum rentals, royalties and bonuses obtainable therefor at the time of such renewal.

The lessee gave a bond in the sum of $10,000 to the satisfaction of the Commissioners. Upon the expiration of that lease the Commissioners re-leased the premises to respondent for oil and gas purposes for another term of five years (R. 73-8).

Respondent's entire income sought to be taxed was earned and received in the operation of those two leases as the lessee, agency or instrumentality of the State in developing and operating its school lands for oil and gas purposes.

RESPONDENT'S PROPOSITIONS

I.

Respondent was a governmental agency or instrumentality of the State of Oklahoma for the development and operation of its State school lands.

II.

Under the Constitution of the United States neither a state nor the United States can tax the governmental agencies or instrumentalities of the other; and if the Revenue Acts of 1917, 1918 and 1919 are construed to impose a tax upon the income of this governmental agency and instrumentality of the State, then the same are to that extent void.

Specifically, a tax upon respondent's income derived from its operation of its State leases is a tax upon the leases themselves; and a tax upon the leases is a tax upon the power of the State to make the leases, and is therefore void.

ARGUMENT AND AUTHORITIES

I.

Respondent was a governmental agency or instrumentality of the State for the development and operation of its governmental lands for governmental purposes.

(a) The establishment and maintenance of free public schools and the fostering of education is a governmental function and duty of the State of Oklahoma.

While petitioner does not question the general proposition, nevertheless in his application for the writ he contends that the establishment and maintenance of public schools is not *strictly* a governmental function. No authorities are cited.

The purpose and aim of government is the happiness, welfare and prosperity of the people. It is only to secure these that "governments are instituted among men." In article III of the Northwest Ordinance, adopted by the Congress under the Articles of Confederation on July 13, 1787, for the government of the Northwest Territory, it is said:

> "Religion, morality and knowledge *being necessary to good government* and the happiness of mankind, schools and the means of education shall forever be encouraged."

Both the Oklahoma Enabling Act and the State constitution recognize and apply this as a governmental maxim, from which it follows that education is both a legitimate

object and an essential means of government, and its promotion is a governmental function. No one will assert that a republican form of government such as ours can endure or accomplish its purpose without a certain degree of education in at least a substantial majority of its citizens. The preservation of the government is a function of government, and the education of its children is essential to its preservation.

The Enabling Act in express terms required that the State, in its organic law, make the establishment and maintenance of free public schools a governmental function and duty; and, that the State might more effectually perform that function and duty, Congress granted to it for that purpose the very lands from the operation of which the income here in question was derived, and provided that such as were valuable for oil and gas should not be sold prior to January 1, 1915, but might be leased, and it prescribed the procedure for the leasing and certain of the terms and provisions of the leases.

Chapter 86, Compiled Oklahoma Statutes, 1921, deals with the public schools of the State. The entire State is divided into school districts, political subdivisions of the State, governed by boards of directors elected by the qualified electors at elections provided for by law. School districts have the governmental power to levy taxes, to issue bonds, to construct school buildings, to employ teachers,

and to determine the period of time, not less than three months, when schools shall be taught each year. Teachers are required to be examined and licensed.

The Oklahoma Supreme Court holds that the education of the children of the State is a "function of government", that it is "an imperative governmental duty to provide for and maintain a system of public education" (*Board of Education of the City of Ardmore* v. *State*, 26 Okla. 366, 370); that "the school district is but a subordinate agency of the State doing the work of the State" (*School District No. 17* v. *Zediker*, 4 Okla. 599, 603); that the establishment and maintenance of public schools, and even the furnishing of free transportation to and from the schools, is the exercise of a governmental function (*Consolidated School District No. 1* v. *Wright*, 128 Okla. 193).

In *State ex rel.* v. *Ross*, 76 Okla. 11, 13, the court said;

> "When organized, the public school districts, of whatever kind, are agencies of the State, prepared for and intended to discharge an important and imperative governmental duty, not only in the matter of education and the economic efficiency attendant thereon, but in a knowledge of our institutions, thereby tending to inculcate in the youthful mind a love of country and a respect for law and good government. There is no more sacred governmental duty than that arising out of our free public school system. Indeed, the very future of the republic may be rested very largely on the education of the youth of the land."

The decisions in other states are to the same effect:

Scown v. *Czarnecki*, 264 Ill. 305.
Landis v. *Ashworth*, 57 N. J. L. 509.
Ward v. *Flood*, 48 Cal. 36.
Piper v. *Big Pine School District*, 193 Cal. 664.
State v. *Powers*, 38 Ohio St. 54.
Howard v. *Tacoma School District*, 88 Wash. 167.
Long v. *Fuller*, 68 Penn. 170.
In re Rees' Appeal (Penn.), 12 Atl. 427, 430.
New Orleans v. *Salmen B. & L. Co.*, 135 La. 828.
Bissell v. *Davison*, 65 Conn. 183.
Kuhn v. *Thompson*, 168 Mich. 511.
Claybrook v. *City of Owensboro*, 23 Fed. 634.

Considering the purpose of government, and that in a government of and by the people the diffusion of knowledge among and the mental development of its citizens is necessary to the accomplishment of that purpose, the maintenance of public schools would seem as strictly governmental in its nature as the preservation of order, the judicial settlement of disputes, the preservation of health, and any other recognized governmental function. It is a means whereby, as this Court said in *Cochran* v. *Board of Education*, 281 U. S. 370, 375, "the common interest is safeguarded." It is not a new policy. It has always been regarded in the United States as one of the highest and most important of governmental functions. Public schools and universities were maintained and operated by the colonies from the earliest colonial times. (Nelsons' Encyclopedia, vol. 10, p. 891; The Americana, Vol. 27, History of Uni-

versity of Columbia; Vol. 29, p. 337; Ellwood P. Cubberly, "An Introduction to the Study of Education," pp. 1-4, 62-3, 357-8.) They were authorized by the colonial laws and the early State constitutions. (See the following from "The Federal and State Constitutions, Colonial Charters and Organic Laws of the United States," compiled in 1878 by Ben. Perley Moore by order of the United States Senate: Constitutions of Georgia, 1777, Art. LIV, p. 383; Massachusetts, 1780, Art. III, p. 957, Chap. V, p. 970; New Hampshire, 1784, p. 1291; North Carolina, 1776, Art. XLI, p. 1414; Vermont, 1777, sec XL, p. 1865; 1786, sec XXXVIII, p. 1874; 1793, sec 41, p. 1882; Pennsylvania Frames of Government, 1683, sec XII, p. 1521; 1696, p. 1535; Constitutions of 1776, sec. 44, p. 1547; 1790, Art. VII, p. 1553.)

In 1779 Thomas Jefferson introduced in the Virginia legislature his famous "bill for a more general diffusion of knowledge", embodying a plan for a public school system in that State. In his first message to Congress in 1790 Washington pointed out the importance of education for the maintenance of the security of the Constitution.

The fact that taxes are permitted to be levied and public moneys to be expended for the maintenance of public schools, that the department of education is made a branch of the executive department of the State, that numerous public officers and boards ranging from the State Superintendent of Public Instruction to district trustees are

elected and paid to carry on the public schools, just as officers are elected and paid to administer justice or carry on any other function of government, all show that the maintenance of public schools is a governmental function in every proper sense of the term. The United States claims no right to tax the salaries of public school teachers. It could not by any law levy a tax upon public school buildings, though the tax were apportioned among the several states in accordance with section 2 of article I of the Federal constitution.

Furthermore, Congress having expressly required the State, by its organic law, to make the establishment and maintenance of public schools a governmental function, it would seem that the United States cannot be heard to say that is not so.

(b) The lease was an instrumentality and respondent was an agency of the State in the performance of this governmental function.

Petitioner says that respondent's production and sale of oil and gas were not acts of government, but were only activities of a private nature, and that neither the production and sale of the oil nor the making of the leases between respondent and the State were directly connected with the operation of the schools.

The governmental function of maintaining public schools involves not only their establishment, but also the

raising of revenue to carry them on; and, under the Enabling Act and the constitution of the State, it was as much a governmental function of Oklahoma to obtain revenue for its public school fund from these governmental lands as it is to obtain such revenue for that purpose by taxation or by the issuance of bonds. The State's leasing power of these governmental lands for governmental purposes was as much a governmental power as is its taxing power or its power to issue bonds for school purposes; and the leases themselves were governmental instrumentalities.

The aim of Congress and the State was to raise money for public school purposes, and the lands and their development and operation through leases were intended to be a means to that end. In principle, there is no distinction between the governmental act of issuing bonds and the governmental act of leasing governmental lands. They are both done for the same purpose, to raise revenue. The purchase of a State bond, so far as the purchaser is concerned, is a mere act of private business. There is nothing essentially governmental in the issuance of bonds. Private business institutions issue them every day, and they are taxable. State bonds and the interest thereon are not taxable, not because of anything peculiar to bonds themselves, but because they are a governmental means of raising money, and to tax the bonds is to tax the power of the State to raise money. It is the power of the government to raise money for governmental purposes that is

protected. That an act is one which may be done by individuals or private corporations does not necessarily stamp it as non-governmental when done by government for a recognized governmental purpose.

In *McCulloch* v. *Maryland*, 4 Wheat. 316, the Bank of the United States, whose capital was privately subscribed, was held to be an agency or instrumentality of the United States, necessary and proper to carry into execution certain of its governmental powers, and therefore not taxable by a State. The operation of the bank was no more an act of government than was the development and operation of Oklahoma's school lands. It was as much an activity incident to carrying on a private business as was the development and operation of Oklahoma's school lands.

In *Weston* v. *Charleston*, 2 Pet. 449, the court held that the tax levied by the City of Charleston upon bonds issued by the United States owned within the city was "a tax upon the contract subsisting between the government and the individual", and therefore void. Here, is not the tax a tax upon the contract between the State and respondent, and therefore void? Was the individual owner of the bonds in that case performing any act of government?

In *Panhandle Oil Company* v. *Mississippi*, 277 U. S. 218, the tax was laid upon a private corporation engaged in distributing gasoline, certainly not an act of government, but only an ordinary private business, not immediately or

directly connected with the exercise of any governmental function. Yet it was held that a State tax levied against that company upon gasoline sold to the United States was void.

In *Indian Motorcycle Company* v. *United States,* not yet reported, the party taxed was a manufacturer and seller of motorcycles, certainly not acts of government, but only a private business; but it was held that the United States could not levy an excise tax upon its sale of a motorcycle to a municipal subdivision of the State.

In *Choctaw, Oklahoma & Gulf R. R. Co.* v. *Harrison,* 235 U. S. 292; *Indian Territory Illuminating Oil Co.* v. *Oklamoa,* 240 U. S. 522; *Howard* v. *Gypsy Oil Co.,* 247 U. S. 503; *Large Oil Company* v. *Howard,* 248 U. S. 549; *Gillespie* v. *Oklahoma,* 257 U. S. 501, and *Jaybird Mining Co.* v. *Weir,* 271 U. S. 609, the parties taxed were private corporations engaged in the production and sale of coal, oil, gas, lead and zinc, ordinarily private businesses; but this Court held that, because they were lessees of restricted Indian lands, they were agencies and instrumentalities of the federal government engaged in the performance of a governmental function, and as such were not taxable by the State.

Here the lands are owned by the State for a governmental purpose. It was intended that the State should derive a revenue from them for a governmental purpose,

and that this should be done through leases. The leasing of this land for that purpose was therefore as much the exercise of a governmental function as the levying of taxes or the issuance of bonds for the same purpose; and the State's lessee bears the same relation to the State that Gillespie, Jaybird Mining Company, Indian Territory Illuminating Oil Company and Choctaw, Oklahoma & Gulf R. R. Co., in the cases last cited, bore to the United States. Government can exercise its functions only through means or agencies designated to carry its powers into execution, and such means or agencies are governmental instrumentalities. It being contemplated that these governmental lands should be developed and operated for governmental purposes, respondent was but doing the work of the State in so developing and operating them. The State might have authorized the Commissioners of the Land Office directly, with tools and machinery belonging to the State, to drill and operate the lands, and in such case the United States could not have taxed any part of the oil produced or the proceeds thereof. If, however, under authority of Congress, the State by and through its leases employed respondent to do this work for it, and gave him a part of its untaxable oil and gas as compensation for so doing, can the United States complain? And is not a tax upon respondent's profits from the leases a tax upon the leases themselves, a tax upon the power of the State to execute

the leases, and a burden upon and a hindrance to the State's exercise of that power?

It is not contended that the State may engage in the oil and gas business generally, purchase lands and leases for that purpose, and, under such circumstances, clothe its lessees or agencies with immunity from federal taxation. The State has not attempted to do so. It has never purchased or leased a tract of land for the purpose of carrying on that business. It has confined itself to developing these governmental lands for governmental purposes, in strict compliance with the terms of the Enabling Act. In such situation the statement of this Court in *Sherman et al.* v. *United States*, 282 U. S. 25, involving the question whether the California Board of State Harbor Commissioners, in operating the State Belt Railroad, was subject to the Federal Safety Appliance Acts, is applicable:

> "California has not gone into the business generally as a common carrier, but simply has constructed the Belt Line as an incident of its control of the harbor—a State prerogative."

No pre-existing source of federal revenue is affected, as was the case in *South Carolina* v. *United States*, 199 U. S. 437, concerning which this Court said in *Murray* v. *Wilson Distillery Co.*, 213 U. S. 151, 173:

> "That case was concerned with the power of a State, by virtue of its legislation in regard to the sale and consumption of liquor, to destroy a pre-existing right of taxation possessed by the government of the United States."

A state's operation and development of its own lands for governmental purposes is not to be likened to its engaging in an ordinary business like that of selling intoxicating liquor. Here, in addition to the governmental purpose aimed at by both the United States and the State, the means of accomplishing it, the ownership, use and disposition of land, was the first, and has always been one of the highest, attributes of sovereignty. When William I conquered England, he took title as sovereign to all the soil, and parcelled it out among his lords and barons as his tenants, and the feudal system then established was based upon the ownership of the soil by the sovereign. The common law doctrine of wardship, the right of eminent domain, and the law of escheats all had their origin under this system and were based upon the sovereign's ownership of the land. The first act of an explorer discovering a new country has always been to claim the new land for his sovereign, and all titles have emanated from the sovereign. In the United States practically all early colonial charters and royal grants contained a provision that the granted land should be held of the sovereign by a common socage tenure, and it was not until after the states succeeded to the authority of the British government that these tenures were abolished. The legislature of New York abolished tenures in socage in capite in 1779. Most of the western states were dotted with land grants from the crown of Spain. All private titles to land within the United

States are derived ultimately from royal grants and from grants from the state or federal government.

The United States owns vast bodies of land. It has the same right of leasing as is incident to absolute ownership by an individual (*Mid-Northern Oil Company* v. *Walker*, 65 Mont. 414; *United States* v. *Gratiot*, 14 Pet. 526; *Hodgson* v. *Midwest Oil Company*, 297 Fed. 273). It may even reserve a part of the rent from leased lands in oil or other products (*Mid-Northern Oil Company* v. *Walker*, *supra*). The Act of February 25, 1920 (41 Stat. 437, c. 85, sec. 1-38), specifically provides for the leasing of lands owned by the United States containing coal, phosphate, oil and gas, oil shale and sodium, and provides for a royalty payable to the United States. If a State in leasing its public lands to obtain revenue for governmental purposes would not be acting in a governmental capacity, performing a governmental function, then the United States does not do so in leasing its lands under this act, and any State in which the land lies may tax the lease and the income of the lessee thereunder, without the consent of the United States and against its will.

Under the common law, in the light of which the Constitution of the United States as respects the proper governmental functions of the states must be interpreted (*South Carolina* v. *United States*, 199 U. S. 437, 449), mines of gold and silver, although on private lands, were the exclusive property of the crown, and did not pass in a

grant by the king under a general designation of lands or mines (*Moore* v. *Smaw*, 17 Cal. 199; *Hicks* v. *Bell*, 3 Cal. 219; *Esquimalt, etc., R. Co.* v. *Bainbridge* (1896), A. C. 561; *Atty. Gen.* v. *Morgan* (1891), 1 Ch. 432; *Lyddall* v. *Weston*, 2 Atk. 20, 26 Reprint 409; *Case of Mines*, Ployd. 310, 33 Reprint 1032, 22 E. R. C. 585; *British Columbia Atty. Gen.*, 14 App. Cas. 295); and, if metalliferous ores contained gold or silver worth extracting, but the ores could not be obtained without interfering with the gold or silver, the whole of such ores belonged to the crown. Except as limited by statute, the crown had the right to work not only gold and silver mines, but also all mines containing gold or silver worth extracting (*Atty. Gen.* v. *Morgan* (1891), 1 Ch. 432). The crown's ownership also extended to all mines and minerals in public reserves, other public lands and the beds of rivers (*Esquimalt, etc., R. Co.* v. *Bainbridge* (1896), A. C. 561; *Woolley* v. *Victoria Atty. Gen.*, 2 App. Cas. 1963). So that the ownership, leasing, and mineral development of land has been a power and function of sovereignty from earliest common law times, and is a very different thing from its engaging in the general private business of buying and selling intoxicating liquor for profit. Under the common law and throughout the history of the United States the former has always been recognized as a proper governmental function; the latter has not.

Certainly, therefore, respondent's leases were governmental instrumentalities; and respondent was a govern-

mental agency of the State for the performance of a proper governmental function, just as were Gillespie, Jaybird Mining Company and Indian Territory Illuminating Oil Company, in the cases heretofore cited, agencies of the United States. The test is not whether such agencies are engaged in a business in which private persons and corporations also engage, but whether the government, by and through them, is performing a proper governmental function.

These lands having been granted for a governmental purpose, and the duty to devote them and the revenue from them to carrying out that purpose having been created by compact between the United States and the State, the provisions of the Enabling Act accepted in the State constitution, the lands were dedicated to this governmental purpose, and their leasing was made a governmental function. The power to tax is the power to destroy; and it would be peculiar if the United States, after granting these lands to the State, and providing that the State might lease them for the governmental purposes stated, should now be held to have the power to destroy the very leases which it authorized and the leasing power which it required the State to assume and exercise. The grant was full and complete for the purpose stated, and the power does not exist in the United States to retake or destroy that which it granted, or to hinder or burden the State's exercise of the governmental power provided for.

II.

Under the Constitution of the United States delegating to it certain powers of government and reserving to the States those not delegated, and intending that each shall exercise its powers so delegated and reserved without hindrance or obstruction by the other, neither a State nor the United States can tax the property or the governmental functions, agencies or instrumentalities of the other. A tax upon respondent's income derived from its State leases is a tax upon the leases themselves, and a tax upon the leases is a tax upon the power of the State to make them, and interferes with the exercise of and may be used to destroy the power. Such a tax is a direct burden upon and interference with the State's exercise of a proper governmental function, the leasing of its school land to obtain revenue for public school purposes. For these reasons, if the revenue acts are construed to apply to respondent's income thus derived, they are to that extent unconstitutional and void.

The 16th Amendment did not extend the taxing power of the United States to new or excepted subjects, but only abrogated the requirement in section 2, Article I of the Constitution, that direct taxes be apportioned among the several states (*Brushaber* v. *Union Pac. R. R. Co.*, 240 U. S. 1, 17-19; *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103; *Peck & Co.* v. *Lowe*, 247 U. S. 165, 172; *Evans* v. *Gore*, 253 U. S. 245); so that the power of the United States to tax the powers and functions of a State and the agencies and instrumentalities through which it carries them into execution is no greater now than it was before the adoption of that amendment.

In the first case dealing with the subject, *McCulloch* v. *Maryland*, 4 Wheat. 316, the court said:

"That the power to tax involves the power to destroy; that the power to destroy may defeat and render useless the power to create; that there is a plain repugnance in conferring on one government a power to control the constitutional measures of another, which other, with respect to those very measures, is declared to be supreme over that which exerts the control, are propositions not to be denied."

And in *Weston* v. *Charleston*, 2 Pet. 449, involving a tax upon bonds issued by the United States, the court said:

"The tax in question is a tax upon the contract subsisting between the government and the individual. It bears directly upon that contract while subsisting and in full force. The power operates upon the contract the instant it is framed, and must imply a right to affect that contract * * *.

"If the right to impose the tax exists, it is a right which in its nature acknowledges no limits. It may be carried to any extent within the jurisdiction of the state or corporation which imposes it, which the will of each state and corporation may prescribe * * *.

"The right to tax the contract to any extent when made must operate upon the power to borrow before it is exercised and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government. To any extent, however inconsiderable, it is a burden on the operations of government. It may be carried to an extent which shall arrest them entirely."

See also:

Bank of Commerce v. *New York*, 2 Black 620.
Dobbins v. *Commissioners*, 16 Pet. 435.
Bank Tax Case, 2 Wall. 200.
The Banks v. *The Mayor*, 7 Wall. 16.
The Collector v. *Day*, 11 Wall. 113.

United States v. *Railroad Company*, 17 Wall. 322.
Telegraph Co. v. *Texas*, 105 U. S. 460.
California v. *Central Pac. R. R. Co.*, 127 U. S. 1.
Wisconsin Central R. R. Co. v. *Price Co.*, 133 U. S. 496.
Pollock v. *Farmers Loan & Trust Co.*, 157 U. S. 429.
Ambrosini v. *United States*, 187 U. S. 1.
Home Savings Bank v. *Des Moines*, 205 U. S. 503.
Williams v. *Talladega*, 226 U. S. 404.
Farmers & Mechanics Sav. Bank v. *Minnesota*, 232 U. S. 516.
Choctaw, Oklahoma & Gulf R. R. Co. v. *Harrison*, 235 U. S. 292.
Indian Territory Illuminating Oil Co. v. *Oklahoma*, 240 U. S. 522.
Evans v. *Gore*, 253 U. S. 245.
Gillespie v. *Oklahoma*, 257 U. S. 501.
Childers v. *Beaver*, 270 U. S. 555.
Jaybird Mining Co. v. *Weir*, 271 U. S. 609.
Northwest Mutual Life Ins. Co. v. *Wisconsin*, 275 U. S. 136.
National Life Ins. Co. v. *United States*, 277 U. S. 508.
Panhandle Oil Co. v. *Mississippi*. 277 U. S. 218.
Indian Motorcycle Co. v. *United States*, — U. S. —.
Group No. 1 Oil Corporation v. *Bass*, 283 U. S. 279.

The exemption from such taxation is mutual and reciprocal. The property and governmental functions of a state and the means and agencies through which it elects to perform them are as free from taxation by the federal government as those of the latter are from taxation by the states,

and for the same reasons. In *Dobbins* v. *Commissioners*, 16 Pet. 435, the court said:

> "There is a concurrent right of legislation in the states and the United States, except as both are restrained by the Constitution of the United States. Both are restrained upon this subject by express prohibition in the Constitution."

In *United States* v. *Railroad Company*, 17 Wall. 322, it is said:

> "The right of the States to administer their own affairs through their legislative, executive, and judicial departments, in their own manner through their own agencies, is conceded by the uniform decisions of this court and by the practice of the Federal government from its organization. This carries with it an exemption of those agencies and instruments from the taxing power of the Federal government. If they may be taxed lightly, they may be taxed heavily; if justly, oppressively. Their operation may be impeded and may be destroyed, if any interference is permitted. Hence, the beginning of such taxation is not allowed on the one side, is not claimed on the other."

In *The Collector* v. *Day*, 11 Wall. 113, the court said:

> "The general government and the States, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres. The former in its appropriate sphere is supreme; but the states within the limits of the powers not granted, or, in the language of the tenth amendment, 'reserved,' are as independent of the general government as that government within its sphere is independent of the States * * *.

"Such being the separate and independent condition of the States in our complex system as recognized by the Constitution, and the existence of which is so indispensable that, without them, the general government itself would disappear from the family of nations, it would seem to follow, as a reasonable, if not necessary consequence, that the means and instrumentalities employed for carrying on the operations of their governments, for preserving their existence, and fulfilling the high and responsible duties assigned to them in the Constitution, should be left free and unimpaired, should not be liable to be crippled, much less defeated by the taxing power of another government, which power acknowledges no limits but the will of the legislative body imposing the tax * * *.

"The supremacy of the general government, therefore, so much relied on in the argument of the counsel for the plaintiff in error, in respect to the question before us, cannot be maintained. The two governments are upon an equality, and the question is whether the power 'to lay and collect taxes' enables the general government to tax the salary of a judicial officer of the State, which officer is a means or instrumentality employed to carry into execution one of its most important functions, the administration of the laws, and which concerns the exercise of a right reserved to the States?"

In *Pollock* v. *Farmers Loan & Trust Company*, 157 U. S. 429, 583, the court said:

"The Constitution contemplates the independent exercise by the Nation and the States, severally, of their constitutional powers.

"As the States cannot tax the powers, the operations, or the property of the United States, nor the means which they employ to carry their powers into execution, so it has been held that the United States

have no power under the Constitution to tax either the instrumentalities or the property of a State."

Even in the dissenting opinion in that case it was said:

> "The instrumentalities employed by the States in execution of their powers are not subjects of taxation by the general government, any more than the instrumentalities of the United States are the subjects of taxation by the States" (p. 562).

In *Evans* v. *Gore*, 253 U. S. 245, 255, the court, referring to the decisions just cited, said:

> "None of those decisions was put on any express prohibition in the Constitution, for there is none; but all recognized and gave effect to a prohibition implied from the independence of the States within their own spheres."

In *Group No. 1 Oil Corporation* v. *Bass*, 283 U. S. 279, the court said:

> "Property sold or otherwise disposed of by the government, either State or National, in order to raise revenue for government purposes, is in a broad sense a government instrumentality, with respect to which neither the property itself before sale nor its sale by one government, may be taxed by the other."

In *Indian Motorcycle Co.* v. *United States*, — U. S. —, it is said:

> "It is an established principle of our constitutional system of dual government that the instrumentalities, means and operations whereby the United States exercises its governmental powers are exempt from taxation by the States, and that the instrumentalities, means and operations whereby the States exert the

governmental powers belonging to them are equally exempt from taxation by the United States. This principle is implied from the independence of the national and state governments within their respective spheres and from the provisions of the Constitution which look to the maintenance of the dual system. *Collector* v. *Day*, 11 Wall. 113, 125, 127; *Willcutts* v. *Bunn*, 282 U. S. 216, 224-225. Where the principle applies it is not affected by the amount of the particular tax or the extent of the resulting interference, but is absolute. *McCulloch* v. *Maryland*, 4 Wheat. 316, 430; *United States* v. *Baltimore and Ohio R. R. Co.*, 17 Wall. 322, 327; *Johnson* v. *Maryland*, 254 U. S. 51, 55-56; *Gillespie* v. *Oklahoma*, 257 U. S. 501, 505; *Crandall* v. *Nevada*, 6 Wall. 35, 44-46."

In the case at bar, a tax on respondent's income as a lessee and agency of the State for developing these governmental lands and making available for governmental uses the revenue intended to be derived from them, is a tax upon the lease itself, a tax upon the State's contract, operates upon the State's power to make the contract, implies a right to affect the contract, and impairs the State's power to contract advantageously. If the right to impose the tax exists, it may be carried to an extent which would destroy the State's power to lease its lands at all.

If the source of the income is not taxable, then the income itself is not taxable. As said in *Oahu Ry. & Land Co.* v. *Pratt*, 14 Hawaii 126, cited with approval by this court in *Gillespie* v. *Oklahoma*, 257 U. S. 501, 506, "a tax on income is in substance and effect a tax on the property

producing the income, and income derived from property exempt from taxation is also exempt."

In *Choctaw, Oklahoma & Gulf R. R. Co.* v. *Harrison*, 235 U. S. 292, the leased land was the property of the Choctaw and Chickasaw Tribes, as here it was the property of the State. The Curtis Bill (Act of June 28, 1898, c. 517, 30 Stat. 495), provided for the allotment of the lands of the Five Civilized Tribes in Indian Territory in severalty among their respective members. The Act reserved the coal lands in the Choctaw and Chickasaw Nations from allotment, provided that the coal thereunder should be the common property of all the members of those two tribes, that the President should appoint two trustees to lease the same, subject to the approval of the Secretary of the Interior, and that the revenues therefrom should "*be used for the education of the children of Indian blood of the members of said tribes.*" Choctaw, Oklahoma & Gulf Railroad Company leased certain of those lands, and developed and operated its lease. A statute of Oklahoma levied a gross revenue tax upon all persons and corporations engaged in mining coal in the State, which was sought to be applied to Choctaw, Oklahoma & Gulf R. R. Co. This court held that the agreement with the Indians imposed a definite duty upon the United States in respect to the operation of the coal mines, and that the coal lessee "is an instrumentality through which this obligation is being car-

ried into effect. Such an agency cannot be subjected to an occupation or privilege tax by a state."

In *Indian Territory Illuminating Oil Company* v. *Oklahoma*, 240 U. S. 522, the Osage Tribe of Indians, under authority of an act of Congress, had executed oil and gas leases upon certain lands in the Osage Nation, now Osage County, Oklahoma. One of those leases had been assigned to Indian Territory Illuminating Oil Company, a private corporation. Oklahoma assessed a tax against that corporation measured by the value of its stock, which in turn was measured by the value of its lease. The State Supreme Court sustained the tax, holding that the company was not a federal agency, that it was a corporation for profit "with which the federal government found it convenient or profitable to deal in carrying out its policy toward the Osage Tribe of Indians. What the State is attempting to do is to tax the property of this corporation within its borders. This certainly is a proper exercise of the taxing power" (*In re Indian Territory Illuminating Oil Co.*, 43 Okla. 307). On appeal this court reversed that decision saying:

> "A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them. If they cannot be taxed as entities, they cannot be taxed vicariously by taxing the stock, whose only value is their value, or by taking the stock as evidence or measure of their value, rather than by directly estimating them as the Board of Equalization and the referee did."

In that case, did the Osage Nation, acting under authority of Congress, exercise any different power in executing the leases from that exercised by the Commissioners of the Land Office, acting under authority of an act of the legislature? Is the governmental power exercised any more sacred in the one case than in the other?

Upon the authority of Choctaw, Oklahoma & Gulf R. R. Co. v. Harrison and Indian Territory Illuminating Oil Company v. Oklahoma, this court affirmed, *per curiam*, judgments of the District Court of the United States for the Western District of Oklahoma in four cases, in which that court enjoined the State Auditor of Oklahoma from collecting the tax assessed upon leases on Indian lands (*Howard* v. *Gypsy Oil Co.*, 247 U. S. 503), and in *Large Oil Co.* v. *Howard*, 248 U. S. 549, reversed another decision of the Supreme Court of Oklahoma similar to that rendered by it in Indian Territory Illuminating Oil Company's case.

Gillespie v. *Oklahoma*, 257 U. S. 501, dealt with the right of the State to levy and collect an income tax upon the net income of persons derived from the operation of leases on restricted Indian lands. Except that in the case at bar the tax was levied by the federal government, and in the Gillespie case it was levied by the state government, the two cases are exactly alike. There Gillespie owned oil and gas leases on lands of individual Creek and Osage In-

dians restricted against sale or incumbrance. Chapter 164, Session Laws of Oklahoma, 1915, levied an annual State tax upon the entire net income, in excess of $3,000, of all persons within the State arising or accruing from all sources. Gillespie contended that, as a lessee of restricted Indian lands, he was an agency of the United States and that his income so derived was not subject to taxation by the State. The State contended, and its Supreme Court held, that the tax was not levied upon the Indians' income or share of the proceeds from the leases, but only upon the lessee's private share, and that the tax was therefore valid (81 Okla. 103). This court reversed the decision, saying:

> "The rule as to instrumentalities of the United States on the other hand is absolute in form and at least stricter in substance. *Williams* v. *Talladega*, 226 U. S. 404, 416, 417, 419. *Johnson* v. *Maryland*, 254 U. S. 51, 55. 'A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them.' 240 U. S. 530. The step from this to the invalidity of the tax upon the income from the leases is not long.
>
> "In cases where the principal is absolutely immune from interference an inquiry is allowed into the sources from which net income is derived, and if a part of it comes from such a source the tax is *pro tanto* void. *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429; 158 U. S. 601; a rule lately illustrated by *Evans* v. *Gore*, 253 U. S. 245, and applied in a case somewhat like the present by the Supreme Court of Hawaii. *Oahu Ry. & Land Co.* v. *Pratt*, 14 Hawaii 126. Whether this property could be taxed in any other form or not, it cannot be reached as profits or income from leases such

as those before us. The same considerations that invalidate a tax upon the leases invalidate a tax upon the profits of the leases, and, stopping short of theoretical possibilities, a tax upon such profits is a direct hamper upon the effort of the United States to make the best terms that it can for its wards. *Weston* v. *Charleston*, 2 Pet. 4429, 468 (p. 505-6)."

Here the State of Oklahoma and its lands were immune from taxation by the United States. The State's power to lease its school lands was immune from taxation by the United States. The lease itself was immune from taxation by the United States, because the power to tax it is the power to destroy it, which power does not exist in the United States. Therefore, the State, the land, the function of obtaining revenue from it, the governmental power of making the leases, and the leases themselves, all being exempt from taxation by the United States, upon what theory can the income be taxed? If "the same considerations that invalidate a tax upon the leases invalidate a tax upon the profits of the leases", then the income from the leases cannot be taxed unless the leases themselves are taxable. If the State's income tax upon Gillespie was "a direct hamper upon the effort of the United States to make the best terms that it can for its wards", then a tax upon the income from these leases is a direct hamper upon the right, power and governmental duty of the State to make the best terms that it can for its wards, the children of the State, to fit whom for citizenship is one of its highest gov-

ernmental duties, and was exactly the duty which the United States was undertaking to perform for the Indians.

Then came *Childers, State Auditor*, v. *Beavers*, 270 U. S. 555, which denied the power of the State to levy an inheritance tax upon the descent of a Quapaw Indian's allotment.

In *Jaybird Mining Co.* v. *Weir*, 271 U. S. 609, the company held a lead and zinc mining lease upon lands of a Quapaw allottee, approved by the Secretary of the Interior. Under that lease it had produced lead and zinc ores which were in its bins at the mine on January 1, 1921. The ores were assessed for ad valorem taxes which the mining company paid under protest. In a suit to recover the tax paid, this court said:

> "The lessee is an agency or instrumentality employed by the government for the development and use of the restricted land and to mine ores therefrom for the benefit of its Indian wards."

The court further said that "the lease was made to secure the development of the land and obtain for the benefit of the restricted Indian owners a percentage of the gross proceeds of the ores to be mined", and it held the tax void.

The governmental power or function which the United States was exercising in behalf of the Indians, constituting the basis of the decisions noted above, was of the same

character as that which the State was exercising in behalf of its children in making the leases here in question, and was exercised to accomplish exactly the same purpose, that is, to fit and prepare the Indians on the one hand and the children on the other for the duties and responsibilities of citizenship. The entire plan of allotting the lands of the Five Civilized Tribes among their members in severalty and of restricting those lands for a time against alienation, was intended, comprehensively, to break up community holdings, teach the Indians the dignity and necessity of labor, inculcate in them the habits of thrift, make them independent and self-supporting, and fit them for citizenship in the State intended presently to be formed out of that territory; in short, to educate them into competent citizens of the State and of the United States. *Woodward* v. *de Graffenreid,* 238 U. S. 284, 309; *U. S.* v. *Rickert,* 188 U. S. 432, 437.

ANSWER TO PETITIONER'S ARGUMENT

I.

Petitioner's contention that the effect of the tax is too indirect and too remote to interfere with any governmental function of the State.

If that is true, then the State's income tax upon Gillespie was too indirect and too remote to interfere with any function of the United States.

Gillespie and respondent were each doing exactly the same thing in the same way, and were each doing it for government to accomplish a governmental purpose. The only difference is that the former was an agency of the United States, while the latter was an agency of the State. Gillespie v. Oklahoma, therefore, rules this case, if, as said in the Metcalf & Eddy case, and in *Dobbins* v. *Commissioners*, 16 Pet. 435; *United States* v. *Railway Company*, 17 Wall. 322; *The Collector* v. *Day*, 11 Wall. 113; *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, and *Indian Motorcycle Company* v. *United States*, — U. S. —, the powers of the United States and of the State to tax each others instrumentalities are limited "in a similar manner." Each of those agencies, being impressed with the same character and entrusted with the same duties in relation to their governmental principals, has the same correlative exemption from taxation, unless an exemption is accorded to the federal government which is to be denied to the state; unless the powers reserved to the states for their preservation and for fulfilling the purposes of their governments are less sacred than those delegated to the United States, and may be destroyed by congressional legislation and the states be reduced from their sovereign stations to mere geographical units or counties of the United States.

Petitioner says that the tax is not laid upon the State, that it is laid upon respondent, a private corporation organized for private profit.

A tax upon the income from the lease is a tax upon the lease itself (*Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 553; *Gillespie* v. *Oklahoma*, 257 U. S. 501), just as a tax upon the interest on a government bond is a tax upon the bond itself. And a tax upon the lease is a tax upon the State's power to execute the lease, and may be used to destroy the power (*Indian Territory Illuminating Oil Co.* v. *Oklahoma*, 240 U. S. 522). The tax is therefore laid upon the State. Its effect is to burden and obstruct the State in its performance of a governmental function. Is it to be supposed that the State could lease this land for a royalty of 50 per cent, as was done here, if it were known that the lessee's profit might be subjected to a surtax as high as 65 per cent in addition to the normal tax? The Secretary of the Interior annually leases lands in the Osage Nation at public auction, for which he receives for the benefit of the Osages bonuses running into many hundreds of thousands of dollars and royalties much higher than are obtainable for leases upon privately owned lands. Were those leases and the income therefrom subject to State taxation, the bonuses and royalties obtainable would be substantially decreased.

Moreover, as to these leases, respondent was more than a mere private corporation or private oil operator, in that it was impressed with an active duty in relation to the governmental purpose of the State, the performance of which in the State's behalf would be obstructed, indeed,

could be wholly prevented, by federal taxation. Both Gillespie and Indian Territory Illuminating Oil Company were also private persons and corporations operating for private profit, but they were not taxable by the State upon their governmental leases or the income therefrom.

Petitioner's argument is exactly that made by the Supreme Court of Oklahoma and rejected by this court. *In re Indian Territory Illuminating Oil Company,* 43 Okla. 307, 319, the Supreme Court of Oklahoma said:

> "Primarily this company is not a federal agency. It is a corporation for profit, incorporated under the laws of the State of New Jersey, and doing business in the State of Oklahoma, with which the federal government finds it convenient or profitable to deal in carrying out its policy toward the Osage tribe of Indians. What the State is attempting to do is to tax the property of this corporation within its borders. This certainly is a proper exercise of the taxing power of the State."

And in the Gillespie case the State did not attempt to tax the royalty payable by Gillespie to the Indians, but only to tax the income "derived from the lessee's private personal share of oil and gas produced under departmental leases upon restricted Indian lands" (81 Okla. 103). But this court held that both Indian Territory Illuminating Oil Company and Gillespie were instrumentalities of the United States, and that neither their leases nor the income therefrom were taxable by the State. The fact that a governmental agency is an individual or private corpo-

ration, and that the inducement to his or its becoming a governmental instrumentality is the hope of private gain, has nothing to do with the determination of the right of taxation. Holders of government bonds are private persons or corporations. United States Marshals, District Attorneys, and other public officers are private individuals, who accept their offices in many cases for the sake of the salary, private gain; but in their relation to the government they are more than mere private persons, and their salaries are not taxable by the states.

Petitioner says that the tax is not laid upon respondent's operations, or upon its gross receipts from oil and gas produced, or upon the making of the lease, but is laid upon its net income derived from all its business; and that the tax is not discriminatory, in that it is laid upon the net income of all corporations similarly situated.

If that reasoning is applicable here, then it was equally so in the Gillespie case. This court has determined that a tax upon the income from the lease is a tax upon the power of the State to make the lease. The tax is, therefore, laid upon the making of the lease. The facts that the tax is laid upon respondent's net income derived from all its business and is not discriminatory are not tests of its validity. Those facts were true of Oklahoma's income tax sought to be applied to Gillespie. Property or income exempt from taxation under the Constitution cannot be taxed

merely by using words embracing all property and all income (*Northwestern Mutual Life Insurance Company* v. *Wisconsin*, 275 U. S. 136; *National Life Insurance Company* v. *United States*, 277 U. S. 508; *Farmers & Mechanics Savings Bank* v. *Minnesota*, 213 U. S. 516; *Home Savings Bank* v. *Des Moines*, 205 U. S. 503). Such a "tax is *pro tanto* void."

Heiner v. *Colonial Trust Company*, 275 U. S. 232, is cited as sustaining a tax which might have "some perceptive economical effect on the Indians"; but that case is without application because there the federal government was taxing its own instrumentality. The court stated that it was beyond the State's power to tax the lessee's income because he was a federal instrumentality, but that the power of the United States to tax its own instrumentalities, if it elected to do so, was undoubted.

Petitioner cites *Flint* v. *Stone Tracy Co.*, 220 U. S. 107. The tax there considered was the corporation tax of 1909, and this court held that it was not a direct tax but an excise on the privelege of doing business in a corporate capacity.

Group No. 1 Oil Corporation v. Bass, 283 U. S. 279, is next cited

That decision turned wholly upon the nature and effect of an oil and gas lease under the laws of Texas, which is

fundamentally different from that of such an instrument in Oklahoma.

In Texas ordinary commercial oil and gas leases are held to be conveyances of an estate in the land and of the oil and gas in place. As to the University lands, the State constitution required the legislature to dispose of them by sale only, and the Texas Supreme Court held that so-called leases of them were in fact "present sales to the lessees of the oil and gas in place." That being true, this court, applying the settled principle that property purchased from the United States or from a state, which has completely passed from the government to the purchaser, becomes a part of the common mass of property and subject to its common burdens, the income from which is none the less taxable because it was acquired from the government, held that the title to the oil and gas in place had completely passed from the State to Group No. 1 Oil Corporation, that the latter owned it in place before it produced it, and that therefore it could claim no immunity from taxation with respect to it.

That is not the case here. In Oklahoma an oil and gas lease is an entirely different thing. In Oklahoma oil and gas, while in the earth, unlike solid minerals, are not the subject of ownership distinct from the soil; an oil and gas lease conveys no estate in the land, does not convey the oil and gas in place, is not a present conveyance of the oil

or gas. It only grants the right to explore for oil and gas and to produce the same from the land, and no title to those substances vests in the lessee until he has brought them to the surface and reduced them to possession.

In *Kolachny* v. *Galbreath*, 26 Okla. 772, the Supreme Court of Oklahoma, passing upon the nature and effect of an oil and gas lease in that State, said:

> "The lease relied upon by the plaintiff does not vest in him the title to the oil and gas in said land, and is not a grant of any estate therein, but is simply a grant of a right to prospect for oil and gas, no title vesting until such substances are reduced to possession by extracting same from the earth—an incorporeal hereditament."

In *Frank Oil Company* v. *Belleview Gas & Oil Company*, 29 Okla. 719, the court said:

> "In *Kolachny* v. *Galbreath et al.*, 26 Okla. 772, it was held that:
>
> " 'Oil and gas, while in the earth, unlike solid minerals, are not the subject of ownership distinct from the soil, and the grant of the oil and gas, therefore, is a grant, not of the oil that is in the ground, but of such a part as the grantees may find, and passes nothing that can be the subject of an ejectment or other real action.'
>
> "And that:
>
> " 'Ejectment will not lie to recover possession of the land covered by such lease against the lessor or his grantee when the lessee has never had possession under said lease.'
>
> "In addition to the authorities cited in support of that conclusion, attention is called to *Backer* v. *Penn*

Lubricating Co., decided by the United States Circuit Court of Appeals for the Sixth Circuit, June 18, 1908 (162 Fed. 627, 89 C. C. A. 418), the opinion being written by Knappen, District Judge, concurred in by Lurton and Richards, Circuit Judges, wherein it is said:

"'The law seems to be settled that, under a lease, of the nature here in question, title to the oil in place is not in the lessee.'

"The lease, under these decisions, does not have the effect of placing the title of the oil and gas that is under the surface of the land in controversy in the lessee, but to grant to the lessee the privilege of exploiting for the oil and gas."

In *Duff* v. *Keaton*, 33 Okla. 92, the court held that an oil and gas lease is not a sale of realty, that in leasing the lands of a minor it is not necessary to follow the statutory procedure for the sale of such lands, and that an oil and gas lease in Oklahoma is personal property. The court then said:

"The rule seems to be settled in this jurisdiction that the grant of an exclusive privilege to go upon land for the purpose of exploring for oil or gas, the grantor to receive part of the oil or gas mined, does not vest in the grantee any estate in the land or oil or gas, but is merely a license or grant; such a lease creating an incorporeal hereditament only, and the lessee having no right or title to the oil or gas lying under the surface of the land. This, under our statute is simply a chattel real."

In *Garfield Oil Company* v. *Champlin et al.*, 78 Okla. 91, the fifth syllabus by the court is as follows:

"Under the decisions of this state, oil and gas, while in the earth, unlike solid minerals, are not subject to

ownership distinct from the soil, and the grant of the oil therefore is a grant, not of the oil that is in the ground, but of such a part as the grantee may find."

In *Hitt* v. *Henderson*, 112 Okla. 194, the court said:

"Many decisions of this court have announced the rule to the effect that the right or interest created by an oil and gas lease creates only the right to explore for and take from the earth any oil and gas found; that the lessee acquires no vested estate in the premises prior to the discovery of oil or gas. *Brennan* v. *Hunter;* 68 Okla. 112, 172 Pac. 48; *Garfield Oil & Gas Co.* v. *Champlin*, 78 Okla. 91, 189 Pac. 514; *First National Bank of Healdton* v. *Dunlap*, decided Jan. 22, 1924 (pending on rehearing).

"In *Brennan* v. *Hunter, supra*, it is held in the fifth paragraph of the syllabus that:

"'An oil and gas lease is not a grant of the oil and gas that is in the ground, but of such part thereof as the lessee may find, and passes no estate that can be the subject of an ejectment or other real action.'"

The Texas constitution required "the legislature to dispose of the University lands by sale only", which means that the legislature was forbidden to grant or authorize the grant of a license to explore and operate the lands for oil and gas purposes. It was required to pass title, to vest an estate in the land. On the other hand, the Oklahoma Enabling Act forbade the State to sell these lands prior to January 1, 1915, but expressly authorized their leasing for oil and gas purposes. So that, while in Texas the State is forbidden to lease University lands for oil and gas purposes, as the term lease is understood in Oklahoma, and is

empowered only to sell, in Oklahoma the State was forbidden to to sell prior to January 1, 1915, and was empowered only to lease.

Respondent was no more a purchaser from the State of the oil and gas under the lands described in its leases than were Indian Territory Illuminating Oil Company and Gillespie purchasers of the oil and gas under their leases. In the Group No. 1 Oil Corporation case it was said that, where restricted Indian property, either real or personal, had passed to a purchaser by a completely executed act of sale, without restriction, and no interest in it had been retained for the benefit of the Indians, the State might tax it. Since, however, the State's right to tax was denied in the Indian Territory Illuminating Oil Company and Gillespie cases, it is evident that the leases in those cases were not considered as vesting title in the lessee to the oil and gas in place; otherwise, the lessee would have had the same status as that of Group No. 1 Oil Corporation, and their leases and the income therefrom must have been held taxable by the State.

Since in Texas the so-called leases were present conveyances of the oil and gas in place, then, subject to the apportionment requirement of Section 2 of Article I of the Constitution of the United States, the federal government could levy a direct tax against the lessee upon the value of the oil and gas in place. But it could not have done so

against respondent, because it owned no oil and gas in place. That belonged to the State of Oklahoma, the owner of the soil. All that respondent had was a contract with the State which gave him the right and imposed upon him the duty to explore and operate the State's land for oil and gas purposes, just as in *Jaybird Mining Co.* v. *Weir*, 271 U. S. 609, 612, this court said that, "the lessee is an agency or instrumentality employed by the government for the development and use of the restricted land and to mine ores therefrom for the benefit of its Indian wards."

The words of grant or lease in the leases construed by this court in Indian Territory Illuminating Oil Company v. Oklahoma, Howard v. Gypsy Oil Company, Large Oil Company v. Howard and Gillespie v. Oklahoma, were not different from those generally used in commercial leases of unrestricted lands in Oklahoma. And the leases executed by the Commissioners of the Land Office of Oklahoma were in fact modeled upon those prepared by the Interior Department and used in leasing the lands in the Osage Indian Reservation and in departmental leases upon lands of the Five Civilized Tribes. Those prepared by the Interior Department provided that the lessor, in consideration of $..... and of the royalties, covenants, stipulations and conditions therein contained and thereby agreed to be paid, observed and performed by the lessee, does thereby demise, grant, lease and let unto the lessee, for five years from the date of approval thereof, and as long thereafter

as oil is found in paying quantities, all the oil deposits in and under the lands described as follows:" (Mills Oklahoma Indian Land Laws, 2nd Ed., page 1037. Also, see Rules and Regulations of Interior Department governing oil leases in Osage Indian Reservation).

The leases executed by the Commissioners of the Land Office of Oklahoma provided that the lessors, in consideration of the royalties, covenants, stipulations and conditions therein expressed and agreed to be paid, observed and performed by the lessee, do thereby lease and let unto the lessee, for a term of five years from and after the date thereof, all oil deposits and natural gas in and under the following described tract of land (R. 67-8 and 74-5).

Considering the nature of an oil and gas lease in Oklahoma, all the implications of Group No. 1 Oil Corporation v. Bass are in respondent's favor. This court there said that property sold or otherwise disposed of by the government, either state or national, in order to raise revenue for governmental purposes, is a governmental instrumentality, with respect to which neither the property itself before sale nor its sale by one government may be taxed by the other. The leased land was therefore a governmental instrumentality of the State of Oklahoma. The leases, being intended "to raise revenue for governmental purposes", were governmental instrumentalities. The leasing of it by the State could not be taxed by the federal government.

No federal tax could be levied upon the leases in the hands of the lessee, because, as said in *Indian Territory Illuminating Oil Company* v. *Oklahoma,* 240 U. S. 522, a tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them. If the leases themselves were not taxable, then the income from the leases is not taxable, for, as said in *Gillespie* v. *Oklahoma,* 257 U. S. 501, "In cases where the principal is absolutely immune from interference an inquiry is allowed into sources from which the next income is derived, and if a part of it comes from such a source, the tax is *pro tanto* void. * * * The same considerations that invalidate a tax upon the leases invalidate a tax upon the profits of the leases."

If any and every oil and gas lessee of state lands, without regard to the nature and effect of his lease under local law, is subject to taxation by the federal government upon such lease or the profits derived from it, then there was no occasion for this court in the Group No. I Oil Corporation case to inquire into the nature and legal effect of a lease in the State of Texas, or to find as the ground of its decision that in that State an oil and gas lease is a present sale to the lessee of the oil and gas in place.

Metcalf & Eddy v. Mitchell, 269 U. S. 514, is cited

Whatever cases may be ruled by that decision, the decision itself pointedly makes it certain that this one is not.

There the court said that whether Congress had power to impose the tax must be answered by ascertaining whether its effect is such as to bring it within "those decisions holding that the very nature of our constitutional system of dual sovereign governments is such as impliedly to prohibit the federal government from taxing the instrumentalities of a state government, and in a similar manner to limit the power of the states to tax the instrumentalities of the federal government." This is another statement that the right of each government to tax the instrumentalities of the other is limited "*in a similar manner.*"

We again say, therefore, that Gillespie v. Oklahoma rules this case; for Gillespie, an oil and gas lessee of the federal government, as respondent was of the State, was held to be such a governmental instrumentality of the United States as not to be taxable by the State. Indeed, in the Metcalf & Eddy case Gillespie, Choctaw, Oklahoma & Gulf R. R. Co. and Indian Territory Illuminating Oil Company are cited by the court as examples of such nontaxable instrumentalities.

Further on the court said that any taxation by one

government of "an agency created and controlled by the other exclusively to enable it to perform a governmental function (*Gillespie* v. *Oklahoma, supra*), is prohibited"; and the court also said that "when the instrumentality is of that character, the immunity extends not only to the instrumentality itself but to income derived from it", and again cited Gillespie v. Oklahoma.

Since the power of the states and the federal government to tax the instrumentalities of the other is limited "in a similar manner", it follows that, as Oklahoma could not tax Gillespie, an oil and gas lessee of Indian lands, similarly the United States cannot tax respondent, an oil and gas lessee of Oklahoma school lands.

Forbes v. Gracey, 4 Otto 762

This case is not in point. It involved the right of a state to tax a mining claim located on lands of the United States under the Acts of July 26, 1866 (14 Stat., p. 251), and of May 10, 1872 (17 Stat., p. 91), which declared the mineral lands of the United States to be free and open to exploration, occupation and purchase by citizens of the United States, under regulations prescribed by law and according to the local custom or rules of miners in the several mining districts, and which provided that the locators should "have the exclusive right of possession and enjoyment of the surface included within the lines of their locations, and of all veins, lodes and ledges throughout

their entire depth, the top or apex of which lies inside such surface lines extended downward vertically."

In Forbes v. Gracey the court said that the miner's possessory right under the statute to explore and work the mine was property which might be sold, transferred, mortgaged or inherited, *without infringing the title of the United States*, and was therefore taxable. Those statutes have also been construed in *Belk* v. *Meagher*, 104 U. S. 279; *Gwillim* v. *Donnellan*, 115 U. S. 45; *Noyes* v. *Mantle*, 127 U. S. 348; *Manuel* v. *Wulff*, 152 U. S. 505; *Black* v. *Elkhorn Mining Co.*, 163 U. S. 445; *St. Louis Mining Co.* v. *Montana Mining Co.*, 171 U. S. 650; *Elder* v. *Wood*, 208 U. S. 226, and *Irwin* v. *Wright*, 258 U. S. 219.

Under the statutes the mining claim is a valuable right, and therefore property. In the case at bar, as in the Gillespie case, the lease confers a valuable right, and is therefore property. But the relation, under those statutes, between the miner and the United States is very different from that between the United States and Gillespie and from that between respondent and the State of Oklahoma. The miner was not an agency or instrumentality of the federal government. He assumed no obligation to it. He was under no contract with it. The legislation of the United States was merely permissive. It neither required nor contemplated that the miner should pay the government any royalty upon the ore mined. He was not an

agency or instrumentality of the government in the performance of any governmental duty. As the court said in Forbes v. Gracey, "It is very true that Congress has, by statutes and by tacit consent, permitted individuals and corporations to dig out and convert to their own use the ores containing the precious metals which are found in the lands belonging to the government, *without exacting or receiving any compensation for those ores, and without requiring the miner to buy or pay for the land*", thus showing the absence of governmental interest, and the fact that the taxation of the claim did not burden or hinder the United States in the performance of any governmental function.

This is further shown in *Irwin* v. *Wright*, 258 U. S. 219, holding in effect that mining claims have always been considered *sui generis*, the court saying:

> "The basis of the mining interest is discovery and location. These give full opportunity to the locator of the claim to take out the mineral, and, since the beginning, this right and interest never has been dependent for its enjoyment on patent, and so it has been taxable. *The rule has always been different in respect to other public lands as the numerous decisions of this court cited above show.*"

Baltimore Shipbuilding Co. v. Baltimore,
195 U. S. 375

That case held only that land conveyed in fee simple by the United States to a dock company, with a provision

in the conveyance that, under certain conditions, the property should revert to the United States, was not, while owned by the dock company, exempt from taxation by the state; that the United States had no present right *in rem*, that its rights were mere conditions subsequent, and that a state tax upon the land, and if necessary, its sale subject to the condition subsequent to enforce payment thereof, the land not being inalienable, did not interfere with any function or right of property of the United States.

Gromer v. Standard Dredging Co., 224 U. S. 362

That case holds that property used by a person in performing a contract with the federal government is not, because of its use, exempt from taxation by a state or territory in which the property has its situs. Petitioner might have cited the later case of *Susquehanna Power Co.* v. *State Tax Commission*, 51 Sup. Ct. 434, not yet officially reported, holding that because appellant was a federal instrumentality, and therefore immune from taxation by the state, "it does not follow that the property appellant uses in its power project is clothed with that immunity"; that "the distinction has long been taken between a privilege or franchise granted by the government to a private corporation in order to effect some governmental purpose, and the property employed by the grantee in the exercise of the privilege, but for private business advantage," and that

"property so owned and used has uniformly been held to be subject to state taxation."

That rule is not novel (*Railroad Co.* v. *Peniston*, 18 Wall. 5). Doubtless the State could have taxed the tools and machinery of Gillespie and Indian Territory Illuminating Oil Company used in drilling their wells and such of their property used in operating the leases as were not fixtures; and that here the United States, had it elected to do so and conformed to the apportionment requirement of the constitution, could have taxed respondent's tools and machinery used in developing and operating these leases; but that is a very different thing from a tax upon the leases themselves or upon the income derived from them.

Alward v. Johnson, 282 U. S. 509

California levied a tax upon companies operating auto trucks, jitney busses and auto stages in the transportation of persons and property as common carriers over highways in the State, and declared the same to be in lieu of all other taxes upon such property of those companies. The State Supreme Court held that the tax was one upon property; and this court, accepting that construction, held, as it did in Gromer v. Standard Dredging Company and Susquehanna Power Company v. State Tax Commission, that the fact that Alward used the property in performing a contract with the United States to carry the mails, did not

exempt it from state taxation, there being no tax upon the contract. That case, of course, is not in point.

Veazie Bank v. *Feno*, 8 Wall. 533, sustained a federal tax upon the notes of state banks used for circulation, but in the opinion the court said:

> "There was nothing in the case showing that the bank sustained any relation to the state as a financial agent, or that its authority to issue notes was conferred or exercised with any special reference to other than private interests."

The court properly held that the United States had full power to tax corporations created by a state or the franchises granted them, so long as they were not acting as governmental agencies of the state. All business done by state corporations is but the exercise of some one or more of the powers, i. e., franchises, granted them in their organization, and certainly the federal government may tax them. The state may not, in creating private corporations to carry on private business, exempt them from federal taxation.

Shaw v. Gibson-Zahniser Oil Corporation, 276 U. S. 575

There the restricted allotted lands of Miller Tiger, a full blood Creek Indian minor, had been leased for oil and gas purposes. With the royalties paid under that lease Tiger's guardian, by permission of the County court, purchased for Tiger from a citizen of Oklahoma a tract of

land not restricted but subject at the time to general, state, county and municipal taxation. The Secretary of the Interior and the County court conditioned the authority for this investment of the minor's funds upon the insertion in the deed to Tiger of a provision that the purchased land "should not be alienated or leased during the lifetime of the grantee prior to April 26, 1931, without the consent and approval of the Secretary of the Interior." The purchased land was subsequently leased for oil and gas purposes, and the lease was acquired by Gibson-Zahniser Oil Corporation. The United States Indian Agency paid in behalf of the minor the ad valorem taxes on the land without objection, but Gibson-Zahniser Oil Corporation refused to pay the State's gross production tax upon its portion of the oil and gas produced, contending that this land had the same status as an original restricted allotment, and that the lessee was therefore a federal instrumentality and exempt from the State's gross production tax. The court held that the purchased lands, and the interest of the lessee in them, were not such instrumentalities of the government as would be declared immune from state taxation in the absence of an express exemption by Congress, even if Congress could exempt them, and that the act of the Secretary in imposing the restriction was not the exercise of any power which might reside in Congress to exempt them from taxation, although as to lessees of restricted allotted lands, "nothing short of an express declaration by Congress

would have subjected them to state taxation." The sum of the decision was that Congress had not purported to exempt this land from taxation, and that the Secretary of the Interior had no power to do so.

South Carolina v. United States,
199 U. S. 437

The facts in that case, the nature of the acts done by the State, the relation of the United States to those acts, and their effect upon the federal government, are entirely different from those in the case at bar.

South Carolina made no pretense of restricting and regulating the use of intoxicating liquors, but declared a state monopoly in the business of selling them for all purposes, beverage, medicinal and industrial, and prohibited sales by any person except the State's dispensers. Because the business was carried on by the State through its dispensers, it contended that the United States could not require of the latter payment of the license or excise tax levied by act of Congress upon those who sold liquor. This court held that it could.

The rationale of the decision is: (a) That the constitution must be interpreted in the light of the common law, the principles and history of which were familiar to its framers. (b) As to excises, the power granted by the constitution to the United States to lay and collect them

is limited only by the provision that they must be for public purposes and must be uniform throughout the United States. (c) At the time of the adoption of the constitution, it was contemplated that the United States would lay and collect excises upon the sellers of intoxicants; also, under the common law, in the light of which the constitution must be interpreted, monopolies were odious, all the avenues of trade were open to the individual, and the possibility of a state's entering that business in a commercial way and monopolizing it was never contemplated. (d) If a state could enter and monopolize that business, and thus exempt its dispensers from payment of the tax, contrary to the intention and expectation of the framers of the constitution, it could monopolize all other avenues of trade, and dry up the sources of federal revenue; and a state's engaging in and monopolizing that business commercially was not the exercise of a proper governmental function within the contemplation of the constitution interpreted in the light of the common law. In short, the decision was put upon the ground that South Carolina could not thus "destroy a pre-existing right of taxation possessed by the government of the United States" (*Murray* v. *Wilson Distillery Co.*, 213 U. S. 151, 173).

The case involved no question of a state's power to own, hold and use its public lands for the accomplishment of a governmental purpose. Many of the states owned large

bodies of public lands at the time of the adoption of the constitution. It involved no question of the power of sovereignty to develop its mineral lands for mineral purposes. South Carolina was not carrying out the terms of a compact between it and the United States which obligated it to do the thing that it was doing.

Here, Oklahoma, in leasing these lands, was executing the terms of a governmental trust. If, instead of leasing only its school lands in conformity with the Enabling Act, it should engage in the oil business generally, for that purpose acquire or take leases upon lands not belonging to it, and should carry on the business, not as a governmental function, the execution of a governmental trust under its compact with the United States, but generally and commercially, and especially if it should undertake to monopolize the business, then doubtless it would fall within this decision, and its agents and instrumentalities for so doing would be taxable. But that is not the case. It has dealt only with its own lands, granted to it by the United States for that purpose, and the leases are a means of accomplishing that purpose.

In the South Carolina case the court also said that the tax was not imposed on any property belonging to the State. Here, the tax ultimately is a tax upon the property of the State. A tax upon the income of the State's lessee is a tax upon the lease, and a tax upon the lease is a tax upon the power of the State to execute it.

II.

Petitioner's contention that, if for any purpose respondent was an agency of the State, it was not exempt from the tax imposed upon income derived from the exercise of non-governmental functions.

We have endeavored to show that these were governmental lands granted and held for governmental purposes, the leasing of which to obtain revenue for those purposes was expressly made a governmental function. If those facts are true, then the lease was a governmental instrumentality and respondent a governmental agency, and its income earned and received in performing this governmental duty in the State's behalf was not derived "from the exercise of non-governmental functions."

The argument that, as lessee of these lands respondent was engaged in producing oil for itself as well as the State, and that, as to its share of the product, it was engaged like any other producer in conducting a business enterprise for private profit, was urged in the Gillespie case, was equally applicable there, and was not availing.

In this connection petitioner quotes from *Clallam County* v. *United States*, 263 U. S. 341, that, "This is not like the case of a corporation having its own purposes as well as those of the United States and interested in profit on its own account" as implying that in this case, if respondent had its own purposes as well as those of the State, and was interested in profit on its own account, its income

from its State leases would be taxable; but the quotation is misapplied. It was not made in relation to the right of Clallam County to tax the income of the Spruce Corporation or a contract between it and the United States, but only the physical property of the Spruce Corporation situated within the county, on the principle of *Railroad Company* v. *Peniston,* 18 Wall. 5, and *Gromer* v. *Standard Dredging Company,* 224 U. S. 362, that property used in doing work or performing a contract for the United States is not, merely because of its use, exempt from state taxation. But this court said that, as the Spruce Corporation was organized by the United States as an instrumentality for carrying on the war, and as all its property was conveyed to it by or bought with money of the United States and was used by it solely as a means to that end, the property was not only used in doing work for the United States but in effect belonged to the United States, and that the corporation had no private purposes to serve, and the quoted statement was made as distinguishing that case from those to which Railroad Company v. Peniston and Gromer v. Standard Dredging Company were applicable. If the United States were attempting to tax respondent's tools and machinery used in developing and operating its lease, then the quotation would be in point; but it has no application when the attempt is to tax the income from a governmental lease, which is a tax on the lease itself and a tax on the power of the State to execute it.

III.

Petitioner's contention that Gillespie v. Oklahoma, 257 U. S. 501, is not controlling.

It is said that that decision is predicated upon the peculiar and anomalous relationship existing between the United States and its Indian wards, and particularly upon the duties and obligations of the federal government as a trustee for the Indians of restricted Indian lands.

The basis of the decision, however, is the governmental power of the United States over the Indians and their lands, and the fact that Gillespie was an agency for carrying into execution certain of those powers. The decision was predicated upon the existence of the power, not upon its source or origin. It is immaterial whether the governmental power of the United States over the Indians and their lands is to be deduced from the power to regulate commerce with the Indian tribes, or to make all needful rules and regulations respecting the territory or other property of the United States, or is implied from the presence of the Indians as semi-organized communities within the territorial jurisdiction of the United States. Whatever the source of the power, it is still a governmental power, and its exercise is the performance of a governmental function. In no respect does it transcend the power of the United States to issue bonds or to exercise any other of its undoubted powers. The execution of the power is protected from

state interference, not because of some peculiar relation between the United States and the Indians which gives rise to the power, but because it is an undoubted governmental power no more to be obstructed or interfered with by the State than is the exercise of any other governmental power of the United States.

The principle which ruled Gillespie v. Oklahoma was stated by the court in terms of general application, as follows:

> "A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them. The step from this to the invalidity of the tax upon income from the leases is not long. In cases where the principal is absolutely immune from interference, an inquiry is allowed into the source from which net income is derived, and if a part of it comes from such a source, the tax is *pro tanto* void."

And, in support of that declaration of the controlling principle, the court cited *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, 158 U. S. 601; *Evans* v. *Gore*, 253 U. S. 245, and *Oahu Ry. & Land Co.* v. *Pratt*, 14 Hawaii 126; none of them Indian cases.

The United States has the same governmental power of legislation over the Indians and their lands that it has over the territories of the United States, explained in *National Bank* v. *County of Yankton*, 101 U. S. 129, 133, which equally may not be interfered with by the states by taxation or otherwise (*Farmers & Mechanics Savings Bank* v. *Minnesota*, 232 U. S. 516).

No useful purpose can be served by elaborating upon the facts that no Indian tribe within the United States has ever been recognized as an independent nation (*Cherokee Nation* v. *Georgia*, 5 Pet. 16; *United States* v. *Kagama*, 118 U. S. 375); that their status has always been that of dependent political communities, and that both they and their lands have always been subject to laws enacted by Congress without their consent (*Stephens* v. *Cherokee Nation*, 174 U. S. 445; *Cherokee Nation* v. *Hitchcock*, 187 U. S. 294; *Lone Wolf* v. *Hitchcock*, 187 U. S. 553; *United States* v. *Kagama*, *supra*); that so-called treaties with them have been mere acts of Congress, "looked upon not as contracts, but as public laws which could be abrogated at the will of the United States" (*Choate* v. *Trapp*, 224 U. S. 665); that the Indian Appropriation Act of March 3, 1871 (16 Stat. 544, 566), provided that no Indian tribe should be recognized as a nation with which the United States might contract by treaty; and that in *Stephens* v. *Cherokee Nation*, *Cherokee Nation* v. *Hitchcock* and *Lone Wolf* v. *Hitchcock*, *supra*, it was held that legislation in direct violation of so-called treaties was valid.

We perceive no difference in purpose and function between the lease in this case and that in the Gillespie case. In each case the lease was a governmental instrumentality and the lessee a governmental agency for the performance of a governmental function. If the fact that the federal government was a trustee for the Indians of their re-

stricted lands is significant beyond giving rise to the governmental power or calling it into play, then it is also a fact that the State, with the assent and participation of the federal government, became and was a trustee for its wards, its children, of these governmental lands. The Enabling Act and the Oklahoma constitution created a governmental trust as to them, and the State pledged its faith to preserve them as a "sacred trust" for the purposes for which they were granted.

The title to the lands was granted to the State in fee simple; but they were granted for the use and benefit of the common schools, to serve a governmental purpose, and the State contracted with the United States to so keep and use them. This constituted a governmental trust. There was no reservation in the Enabling Act of right on the part of the United States to tax these lands or the State's power to lease them in executing this governmental trust. And such a right, inconsistent with the grant and the purpose of the grant, with the relation between the states and the United States, and with the plan and purpose of the Union, and derogatory to the dignity and sovereignty of the State and to its supremacy in its sphere, cannot rest upon implication. On the other hand, the fact that the lands were granted to the State by the United States for the very governmental purpose to which they are being put, and that the grant specifically provided that the State should not sell but might lease them in execution of the

trust, negatives the existence of any intention, right or power on the part of the United States to tax the land or the development and operation thereof. The grant for the purpose specified in the Enabling Act, specifically accepted in the State constitution, constitutes an inviolable contract or compact between the United States and the State; and for the United States to tax the land, the leases thereon executed in conformity with the contract or the income therefrom, tends to frustrate the governmental purpose aimed at, hinders the State in carrying out that purpose, lessens the value of the grant, burdens the exercise by the State of the governmental trust thus created and assumed, and violates the compact.

We think there is no weight in petitioner's argument that, in the Gillespie case, it was *agreed* that Gillespie was an instrumentality of the United States in carrying out its duties to the Indians, whereas petitioner makes no similar concession in this case. That Gillespie was such instrumentality is undoubted. The fact had already been determined in the cases of Choctaw, Oklahoma & Gulf R. R. Co. v. Harrison and Indian Territory Illuminating Oil Co. v. Oklahoma. The decision in the Gillespie case would not have been different had the State made an issue upon that question. Also, that the lessee was such instrumentality was expressly ruled in the Jaybird Mining Company's case.

Petitioner says that he sees no difference in substance between respondent and Group No. 1 Oil Corporation. In

that company's case, however, this court clearly pointed out the distinction between Group No. 1 Oil Corporation and Gillespie, and said in effect that if Gillespie had purchased the oil and gas in place as did Group No. 1 Oil Corporation, he would have been taxable by the State. As Group No. 1 Oil Corporation bought from the State of Texas the oil and gas in and under the land, and owned it at all times thereafter, while respondent did not and could not buy the oil and gas in place, but was only an agency of the State for the development and operation of this governmental land in the execution of this governmental trust, the difference between that case and this is that existing between an owner mining his own mineral for his own account and a governmental lessee performing a governmental function for the State. And, as already pointed out, Group No. 1 Oil Corporation could have been taxed by the federal government, under proper apportionment, upon the value of the oil and gas in place. Respondent could not, for it owned no oil and gas in place.

The decision of the court below should be affirmed.

Respectfully submitted,

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January, 1932.

APPENDIX A

(Applicable Portion of Section 8 of Enabling Act, 34 Stat. 273)

Where any part of the lands granted by this Act to the State of Oklahoma are valuable for minerals, gas and oil, such lands shall not be sold by the said State prior to January first, nineteen hundred and fifteen; but the same may be leased for periods not exceeding five years by the State officers duly authorized for that purpose, such leasing to be made by public competition after not less than thirty days' advertisement in the manner to be prescribed by law, and all such leasing shall be done under sealed bids and awarded to the highest responsible bidder. The leasing shall require and the advertisement shall specify in each case a fixed royalty to be paid by the successful bidder, in addition to any bonus offered for the lease, and all proceeds from leases shall be covered into the fund to which that shall properly belong, and no transfer or assignment of any lease shall be valid or confer any right in the assignee without the consent of the proper State authorities in writing: Provided, however, That agricultural lessees in possession of such lands shall be reimbursed by the mining lessees for all damage done to said agricultural lessees' interest therein by reason of such mining operations. The Legislature of the State may prescribe additional legislation governing such leases not in conflict herewith.

(Section 9 of Enabling Act, 34 Stat. 274)

That said sections sixteen and thirty-six, and lands taken in lieu thereof, herein granted for the support of the common schools, if sold, may be appraised and sold at public sale in one hundred and sixty-acre tracts or less, under such rules and regulations as the Legislature of the said State may prescribe, preference right to purchase at the highest bid being given to the lessee at the time of such sale, the proceeds to constitute a permanent school fund the interest of which only shall be expended in the support

of such schools. But said lands may, under such regulations as the Legislature may prescribe, be leased for periods not to exceed ten years; and such lands shall not be subject to homestead entry or any other entry under the land laws of the United States, whether surveyed or unsurveyed, but shall be reserved for school purposes only.

APPENDIX B

(Section 1 of Article XI of Oklahoma Constitution)

The State hereby accepts all grants of land and donations of money made by the United States under the provisions of the Enabling Act, and any other Acts of Congress, for the uses and purposes and upon the conditions, and under the limitations for which the same are granted or donated; and the faith of the State is hereby pledged to preserve such lands and moneys and all moneys derived from the sale of any of said lands as a sacred trust, and to keep the same for the uses and purposes for which they were granted or donated.

APPENDIX C

(Ordinance Accepting Enabling Act)

Be It Ordained by the Constitutional Convention for the proposed State of Oklahoma, that said Constitutional Convention do, by this ordinance irrevocable, accept the terms and conditions of an Act of Congress of the United States, entitled, "An Act to Enable the People of Oklahoma and the Indian Territory to form a Constitution and State Government and be admitted into the Union on an equal footing with the original states; and to Enable the People of New Mexico and Arizona to form a Constitution and State Government and be admitted into the Union on an equal footing with the original states," approved June the sixteenth, *Anno Domini,* Nineteen Hundred and Six.

(Section 1 of Article VI of the Oklahoma Constitution)

The Executive authority of the State shall be vested in a Governor, Lieutenant Governor, Secretary of State, State Auditor, Attorney General, State Treasurer, Superintendent of Public Instruction, State Examiner and Inspector, Chief Mine Inspector, Commissioner of Labor, Commissioner of Charities and Corrections, Commissioner of Insurance, and other officers provided by law and this Constitution, each of whom shall keep his office and public records, books, and papers at the seat of government, and shall perform such duties as may be designated in this Constitution or prescribed by law.

(Section 2 of Article XVII of the Oklahoma Constitution)

There are hereby created, subject to change by the Legislature, in and for each organized county of this State, the offices of judge of the County Court, County Attorney, Clerk of the District Court, County Clerk, Sheriff, County Treasurer, Register of Deeds, County Surveyor, *Superintendent of Public Instruction,* three County Commissioners, and such municipal township officers as are now provided for under the laws of the Territory of Oklahoma, except as in this Constitution otherwise provided.

(Sections 1, 4 and 5 of Article XIII of the Oklahoma Constitution)

Section 1. The Legislature shall establish and maintain a system of free public schools wherein all the children of the State may be educated.

Sec. 4. The Legislature shall provide for the compulsory attendance at some public or other school, unless other means of education are provided, of all the children in the State who are sound in mind and body, between the ages of eight and sixteen years, for at least three months in each year.

Sec. 5. The supervision of instruction in the public schools shall be vested in a Board of Education, whose powers and duties shall be prescribed by law. The Superintendent of Public Instruction shall be President of the Board. Until otherwise provided by law, the Governor, Secretary of State, and Attorney General shall be ex-officio members, and with the Superintendent, compose said Board of Education.

APPENDIX D

(Sections 2 and 3 of Article XI of the Oklahoma Constitution)

Sec. 2. All proceeds of the sale of public lands that have heretofore been or may be hereafter given by the United States for the use and benefit of the common schools of this State, all such per centum as may be granted by the United States on the sales of public lands, the sum of five million dollars appropriated to the State for the use and benefit of the common schools in lieu of sections sixteen and thirty-six, and other lands of the Indian Territory, the proceeds of all property that shall fall to the State by escheat, the proceeds of all gifts or donations to the State for common schools not otherwise appropriated by the terms of the gifts, and such other appropriations, gifts, or donations as shall be made by the Legislature for the benefit of the common schools, shall constitute the permanent school fund, the income from which shall be used for the maintenance of the common schools in the State. The principal shall be deemed a trust fund held by the State, and shall forever remain inviolate. It may be increased, but never be diminished. The State shall reimburse said permanent school fund for all losses thereof which may in any manner occur, and no portion of said fund shall be diverted for any other use or purpose.

Sec. 3. The interest and income of the permanent school fund, the net income from the leasing of public lands

which have been or may be granted by the United States to the State for the use and benefit of the common schools, together with any revenues derived from taxes authorized to be levied for such purposes, and any other sums which may be added thereto by law, shall be used and applied each year for the benefit of the common schools of the State, and shall be, for this purpose, apportioned among and between all the several common school districts of the State in proportion to the school population of the several districts, and no part of the fund shall ever be diverted from this purpose, or used for any other purpose than the support and maintenance of common schools for the equal benefit of all the people of the State.

APPENDIX E

(Section 32 of Article VI of the Oklahoma Constitution)

The Governor, Secretary of State, State Auditor, Superintendent of Public Instruction, and the President of the Board of Agriculture, shall constitute the Commissioners of the Land Office, who shall have charge of the sale, rental, disposal, and managing of the school lands and other public lands of the State, and of the funds and proceeds derived therefrom, under rules and regulations prescribed by the Legislature.

APPENDIX F

(Sections 9415, 9417, 9418 and 9423, Compiled Oklahoma Statutes, 1921)

9415. When any tract of the school or other public lands, granted to the State of Oklahoma under the act of congress known as the "Enabling Act" is known by the commissioners of the land office of the State to contain oil or gas, or where such lands are, by said commissioners,

deemed valuable for oil and gas purposes, such commissioners shall enter of record in their office their finding, declaring that such oil or gas character exists, and further declaring that the oil and gas deposits are segregated from the surface use and interest therein, and such segregation of such deposits shall conclusively withhold the same from sale, lease or other alienation, except as provided in this article.

9417. The oil and gas interest described in this article in such lands may be leased by the commissioners of the land office for oil and gas purposes to the same extent and in the same manner as a private owner of lands in fee could, in his own right, execute a grant thereto, subject, however, to the following limitations:

First. For a period not exceeding five years, with suitable provisions for preference right to release for a second term of five years at its expiration, at the maximum rate of rentals, royalties and bonuses that may be obtained therefor, at the time of such renewal.

Second. Upon due advertisement and public notice of not less than thirty days, in such manner as the commissioners may, by rule, prescribe.

Third. Such leasing shall be done under public bids and awarded to the highest responsible bidder: Provided, that the commissioners of the land office shall have power to reject any and all bids.

9418. The lease contract of the State with any lessee for oil and gas purposes shall stipulate, and the advertisement for bids for leasing such land shall specify, a fixed royalty, to be determined by the commissioners of the land office, and in no event less than twelve and one-half per cent of the total output of such oil and gas, and in addition thereto any bonus offered for such lease, and shall also require a deposit of sufficient earnest money in the hands of the commission as the commission may require to accompany each bid, with appropriate conditions of forfeiture for failure to comply with the terms and conditions of bid-

ding upon such lands. All leases for oil and gas provided in this article shall contain a provision requiring the lessee to drill a sufficient number of wells upon the leased premises to offset the wells upon adjoining contiguous premises, and a further provision that a failure to faithfully operate the leased premises for oil and gas to as full an extent as individual and corporate premises are being operated within the general oil and gas field where such land is located, shall forfeit such lease to the State. No transfer or assignment of any lease shall be valid or convey any right in the assignee without the consent in writing of the commissioners of the land office. The board of commissioners shall require a good and sufficient bond for the faithful performance of said lease and may make such additional rules and regulations covering same as are not specifically provided for in this article.

9423. The proceeds derived in bonuses and royalties and from other inducements and considerations for the execution and operation of the oil and gas leases in this article provided, shall be carried in the several funds, for the use and benefit of which such lands were granted by the United States to the State of Oklahoma, and to the territory now comprising the area embraced within the said State, under the provisions of the enabling act, and any and all other acts of Congress, for the uses and purposes, and upon the conditions, and under the limitations for which the same were granted; and the money resulting from such lease and from the operation thereof shall be handled, disposed of and used in like manner as the other moneys belonging to said several funds under the laws of this State.

APPENDIX G

(Sections 9424 and 9430, Compiled Oklahoma Statutes)

9424. The Commissioners of the Land Office are authorized to lease for oil and gas purposes any of the school

or other lands owned by the State of Oklahoma, which such commissioners may deem valuable for oil and gas, for the term of five years and as long thereafter as oil or gas may be produced therefrom in paying quantities, upon such terms and conditions and in such quantities as the commissioners shall by rules and regulations prescribe. Each such lease shall provide for the delivery to the State of a royalty of not less than one-eighth part of the oil or gas produced from the leased premises or in lieu thereof the payment to the State of the market value of said royalty interest, as the commissioners may elect. Such leasing shall be made by public competition after not less than 30 days' notice by publication in two newspapers authorized by law to publish legal notices, one of which newspapers shall be published at the State Capitol, and the other in the county where the land is situated, such leasing shall be let by sealed bids and each lease awarded to the highest responsible bidder. Such oil and gas leases may be assigned only with the consent and approval of the Commissioners of the Land Office. Provided, that the commissioners have the right to reject any and all bids.

9425. The commissioners are empowered to segregate any of the school or public lands for mineral purposes which the commissioners may, by order entered of record, determine to be valuable for oil, gas or mineral purposes, and each agricultural, grazing or other lease of the surface rights or interest in any land so segregated shall reserve to the State, its lessees or grantees, the right to explore, drill and operate for oil or gas on such lands as well as the right to enter upon the said lands and enjoy the mining rights so reserved.

9426. All oil and gas leases executed by the Commissioners of the Land Office shall be for a term of five years and as long thereafter as oil or gas may be produced in paying quantities; provided, upon the forfeiture, or cancellation or surrender, or expiration of lease by reason of its termination on account of the five-year limit, provided for in the "Enabling Act," or any other cause, the School

Land Commissioners shall provide for the leasing of such land in the same way and in the same manner that the School Land Commissioners lease land which has never been leased: Provided, on such leases which are surrendered or which may expire or which have expired, the lessees or assigns shall have the value of the physical properties on such lease, which value shall be determined by a board of appraisers especially appointed by the School Land Commissioners for the appraising of physical property of leases. Provided, no physical property valuation shall be attached or considered in the making of a lease on a tract consisting of more than 640 acres. If no well shall be completed upon any leased premises within one year from the date of the lease, the lessee shall pay to the State of Oklahoma an annual rental in advance of such sum per acre as the commissioners shall prescribe in the lease, which payment shall operate to defer the completion of a well during the year for which such rental payment is made.

9427. All leases for oil and gas shall contain a provision to drill one well on each leased tract within one year from the date of such lease or on failure to complete such well to pay an annual rental per acre as hereinbefore provided. All such leases shall further provide that the lessee shall drill a sufficient number of wells upon the leased lands to offset all producing wells upon any adjoining or contiguous lands, and a further provision that the failure of the lessee to diligently and in good faith operate the leased premises for oil and gas to as full an extent as other lands are operated in the general oil and gas field where such leased lands is located shall forfeit all rights of the lessee under such lease. Each lessee shall execute a bond to the State of Okahoma with sureties to the approval of the commissioners and in such sum as the commissioners shall prescribe, conditioned for the faithful performance of the provisions of the lease and for the payment of all recoverable damages which such lessee may cause to the property, crops or rights of the surface lessee.

Each lease shall further provide that in the event the

State shall at any time operate a refinery for the refining of crude petroleum or the extraction of any of its products or by-products, the State shall have the preference right to purchase and take the production or output of any such oil or gas well at the prevailing market price thereof, upon the commissioners serving written notice upon the owners of any well, of the purpose and readiness of the State to take such production.

9428. The Commissioners of the Land Office may adopt and promulgate appropriate rules and regulations for carrying into effect the provisions of this act, but no restrictions or prohibitions against any bidder or prospective bidder shall be made other than as provided in this act.

9429. The lessee, under any oil or gas lease executed by the Commissioners of the Land Office shall be liable to the surface owner or lessee for all injury, damage or loss occurring to the surface interest, interest in such lands or to any building, crops or improvements, or other property, located upon or used in connection with said land.

9430. All funds arising from bonuses, royalties or rentals for oil and gas leases, shall be carried into and credited to the permanent funds for the use and purpose designated in the grant of such lands by Congress to the State of Oklahoma and all such funds shall be kept, handled and used in like manner as other moneys belonging to said permanent funds.